

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Burton Analyst: Norman Catelli Bill Number: SB 640

Related Bills: See Prior Analysis Telephone: 845-5117 Amended Date: June 19, 2003

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: State Agency Contracts/Expatriate Corporations/California Taxpayer and Shareholder Act of 2003

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended May 7, 2003.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED May 7, 2003. STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY

This bill would prohibit the state, absent a compelling public interest, from entering into contracts or agreements with certain publicly traded foreign (non-U.S.) corporations.

SUMMARY OF AMENDMENTS

The June 19, 2003, amendments would:

- Expand the definition of expatriate corporations to include corporations whose reorganization transactions result in more than 50% ownership by domestic shareholders or partners (not just former shareholders or partners),
- Permit contracts with corporations that expatriated before January 1, 2004, if that corporation:
 - Provides shareholders with enumerated rights, and
 - Agrees to calculate state income tax liability using worldwide combined reporting,
- Permit the designee of the chief executive officer of a state department or agency to make a written finding of a compelling public interest,
- Require vendors to self-certify eligibility with the contracting agency for calendar year 2004,
- Require vendors to self-certify eligibility with the Department of General Services for calendar year 2005 and thereafter, and
- Apply this bill's provisions to corporations that expatriated before January 1, 2004, for contracts entered into on or after April 1, 2004.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Legislative Director
Brian Putler

Date
7/11/03

POSITION

Pending.

Summary of Suggested Amendments

As noted in the analysis of this bill as amended May 7, 2003, amendments are needed to clarify various definitions used in this bill. See "Implementation Considerations" below. Amendments are also needed to resolve the "Technical Considerations" noted below. Department staff is available to assist the author with amendments.

IMPLEMENTATION CONSIDERATIONS

The concept of "substantial business activities" in the place of incorporation plays a significant role in this bill, but the statutory language does not define the concept. The bill lacks qualitative or quantitative standards by which the substantiality of business activity is to be evaluated for this purpose. Since this bill is evaluating foreign corporations, it may be advisable to consider how the United Kingdom and other European tax systems incorporate the concept of "substantial business activities."

The term "substantially all" referring to the acquisition of a domestic corporation's properties requires a definition. The phrase is not specifically defined in the Internal Revenue Code reorganization provisions, although federal case law and administrative pronouncements have defined it in certain contexts. For example, a corporation's interest expense deduction on debt incurred to acquire another corporation is limited. For this purpose, "substantially all" is defined as 90% of the fair market value of the net assets or 70% of the fair market value of the gross assets. Similarly, for purposes of certain corporate reorganizations or inclusion in a federal consolidated income tax return, "substantially all" is defined as 80% of stock value and voting power. Additionally, in certain corporate reorganizations there is a "continuity of interest" requirement to prevent transactions that resemble sales from benefiting from favorable treatment. For this purpose, 50% of the value of the new stock is to be received by the former owners to receive the favorable treatment.

The provision relating to the stock of the new parent held by former shareholders or partners requires clarification. In an effort to avoid being classified as an "expatriate corporation" the former owners may receive securities other than common stock, thus keeping the 50% ownership threshold from being met. Some securities that may be used to avoid the expatriation threshold are convertible debt, tracking stock, and exchangeable stock.

Subparagraph (A) of paragraph 1 of subdivision (b) contains the phrase "... the public trading of the foreign incorporated entity." This phrase probably should be modified to refer to "... the public trading of stock of the foreign incorporated entity."

TECHNICAL CONSIDERATIONS

This bill would add Article 11 to Chapter 1 of Part 2 of Division 2 of the Public Contract Code. This new article would prevent certain foreign corporations from being awarded state contracts for public works, goods, or services. The existing provisions of Chapter 1 relate to contracts for public works. However, the provisions of Chapter 2 relate to contracts for goods and services. Consequently, this bill would add language regarding contracts for goods and services (Chapter 2) into the chapter relating to contracts for public works (Chapter 1).

LEGISLATIVE STAFF CONTACT

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